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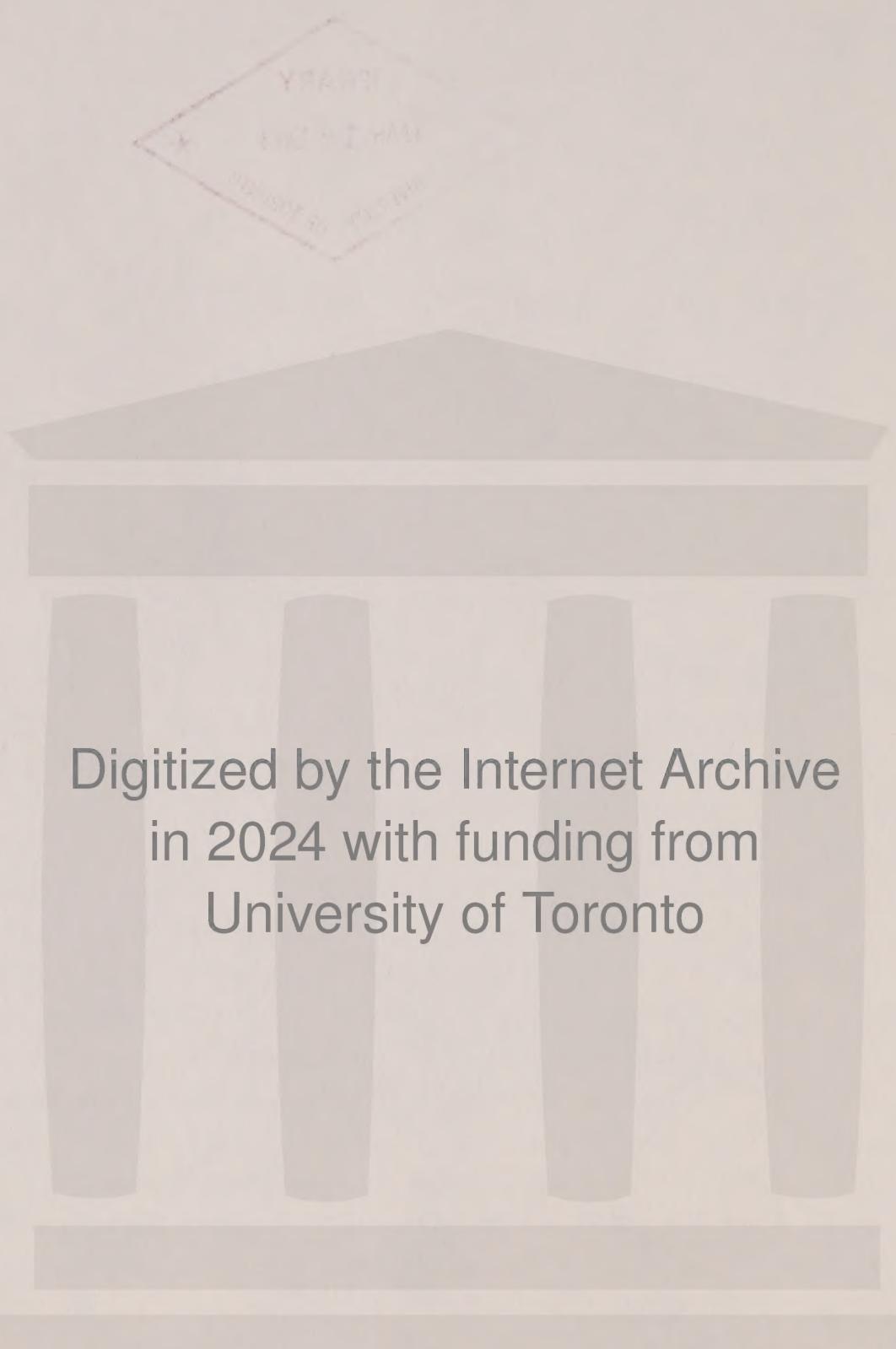
TORONTO, March 7, 1983 The Ontario Economic Council Study: A SEPARATE PERSONAL INCOME TAX FOR ONTARIO: AN ONTARIO ECONOMIC COUNCIL POSITION PAPER, is the Council's response to the following Reference from the Treasurer of Ontario:

"What would be the economic implications if the Province of Ontario were to withdraw from the present Tax Collection Agreement with the federal government and institute its own personal income tax collection system?"

The Council's overall conclusion is that Ontario not proceed with a separate personal income tax (PIT) at this time. There are simply too many avenues yet to explore before such a move could be justified. However, the Council recognized the serious strains currently surrounding the Tax Collection Agreements and concluded that both the federal government and the provinces have to accept part of the blame for the current impasse. In terms of recommendations, the Council study suggested that "the federal government either allow the provinces to have a greater voice in the determination of the shared (PIT) tax structures and/or allow them more flexibility to offset those features of the federal PIT that they find deleterious to their own interests."

"For their part, the provinces have to take some important steps toward ensuring that the internal common market will not be fragmented by provincial actions."

For more detail pertaining to the Council's overall conclusions and recommendations, see Press Release No. 1.



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o In terms of the benefits and costs of a separate PIT, the Council focussed on a wide range of issues - the implications for savings, corporate investment, small businesses and venture capital, stabilization, income distribution, administration and compliance costs, federal-provincial relations and political costs and benefits. These are summarized in Tables 15 and 16 of Chapter 19. A few examples follow.

o Administrative and Compliance Cost

o The Council produces several different estimates of the costs of administration. Its best guess as to the administration costs are as follows:

1. \$75-\$100 million (1982 dollars) is the likely range for the annual cost of administering a separate Ontario PIT.
2. The start-up costs and capital investment in buildings and equipment would be in the \$60 million range.
3. For the most part, these would represent net increases in collecting personal income taxes since the cost savings to the federal government as a result of a separate Ontario PIT would be minimal.

o Compliance costs include the following:

1. The additional costs to individual taxpayers who gather together the necessary receipts or other documents in support of a tax return, study the requisite forms and accompanying information, and carry out the computations involved in completing their own returns.
2. The additional out-of-pocket costs to those who engage professionals to complete their returns. Included in both (1) and (2) are the additional costs of tax planning resulting from any divergences in tax treatment between the Ontario and federal systems.

3. The additional costs to businesses that provide their employees with professional tax advice as part of their employee benefit packages.
  
4. The additional costs to businesses of modifying their payroll systems in order to withhold PIT deductions at source.

The Council estimates that these costs of compliance will be larger than the costs of administration. Specifically, the annual costs are expected to fall in the \$105-\$285 million with an initial start-up cost to employers of \$30-\$60 million. As with administrative costs, these will represent a net increase in compliance costs, since the costs of compliance for the federal portion of the PIT will remain basically unchanged. (See Chapters 15 and 16 for more detail).

#### Political Costs and Benefits

These relate to the relationship between the citizens and their province. Included among the benefits of a separate PIT would be the following:

- The province would have the ability to disassociate itself from unpopular and otherwise inappropriate federal PIT reforms.
  
- The politicians would have more ability to target tax changes to particular groups.
  
- The province might acquire increased bargaining power vis-a-vis the federal government. This could come in several ways. First of all, Ottawa might be interested in consultation prior to any federal tax changes in order to see if there were federal tax options which Ontario might parallel in its own tax legislation. Second, the province could now signal its intent to alter some aspect of the tax structure and this might lead to federal-provincial discussions on the issue in question. Finally, the

presence of a qualified civil service relating to PIT matters should lead to a substantial increase in the communication links between Ontario and Ottawa.

- The large numbers of taxpayers who would receive tax refund cheques from Queen's Park would increase their identification with Ontario.
- More generally, there would be an increased awareness on the part of Ontarians of the role that the provincial government plays in their lives. This might be channelled into an increased interest generally in provincial affairs.

Included in the costs of a separate PIT are the following:

- A much greater tax visibility for the province. Taxpayers would now make out cheques directly to Queen's Park. Employers would have to withhold taxes on behalf of the province and prepare the Ontario equivalent of T4 slips, etc.
- The province would likely be bombarded by lobbies for special interest groups seeking every manner of concession and/or special treatment.
- Taxpayer uncertainty would likely increase as citizens recognized that there are two levels of government with the power to directly affect their level of take-home pay.
- Other provinces' views of Ontario would probably be altered considerably. For example, it is likely that some of the smaller provinces for whom a separate PIT is not a viable alternative would tend to view Ontario as a source for potential balkanization of the federation.

#### Growth and Efficiency

- With respect to labour supply and quality, a separate PIT might play a role that would be conducive to enhancing the

province's growth prospects, but in general there are alternative ways to achieve these goals.

- It is clear that the provisions of a separate PIT can have a substantial influence on people's choices of the channels through which they save. Moreover, by channelling savings to areas where capital markets do not function well, a PIT can have an influence on investment and growth.
- The PIT treatment can have a considerable influence on the returns to corporate investment. With sufficient capital market imperfection, such an integration can enhance the overall level of investment. However, considerable uncertainty attaches to these results. In general, it would appear that Ontario can achieve the same goals by appropriate modifications in the corporate tax system.
- There is a greater role for a PIT in affecting the flow of funds to small businesses and venture capital firms. Special tax treatment of investment income from these sources would channel more funds in their direction. However, the Council's view is that the present legislation relating to the SBDCs and Small Business Bonds already plays a valuable role in this area. It is not evident that the additional leverage obtainable through a separate PIT would justify a move away from the Tax Collection Agreements.
- That the PIT can influence both savings and investment appears very evident from the analysis of the proposed federal reforms to correct the PIT for the inflation distortion. The Council feels that it is imperative that the Ontario Treasury take a very active role in the forthcoming reform process, particularly the proposed study of the tax treatment of personal and business investment income. We view these proposals as constituting one of the most fundamental reforms of the tax system in the post-war period. Only when the reforms are implemented will it be possible to assess what further advantages would accrue to the province from adopting an independent PIT.

## Policy

uncil believes that the principal responsibility for  
tion policy has to reside at the federal level.

ess, there is an important provincial role in stabiliz-  
lity. This is particularly the case for jurisdictions as  
Ontario.

significant difference in economic structures across  
and the political limitations of regionally differentiating  
fiscal policy, the role of provincial stabilization policies  
more important.

sult, it is entirely possible for overall federal policies  
conflict with the stabilization needs of Ontario. When  
he case, the existing PIT system magnifies the degree  
propriateness, since Ontario has to parallel the federal  
in its own PIT.

ate PIT would remove this problem and would provide  
with additional flexibility to achieve the multiple goals  
ization policy. One obvious advantage would be that  
could provide equivalent treatment for the corporate  
corporated sectors.

ate PIT would also have an impact on federal stabiliza-  
lity. In particular, it would remove Ottawa's present  
, which it can use to force the provinces to share  
the burdens (and some of the benefits as well) of  
ion measures undertaken via PIT changes.

age is a problem, it can be handled through increased  
provincial cooperation and consultation relating to  
changes in the common PIT structure. Or it can be  
by having the federal government introduce tax  
by means of federal tax credits (i.e., leaving 'basic  
ax' unchanged).

- While it appears that a separate PIT could provide some advantages with respect to stabilization policy, it is nonetheless the case that, in general, measures relating to expenditure changes are more effective in influencing aggregate demand than measures undertaken through general tax changes.

### Distribution

- A separate PIT would give a province more freedom to determine both the overall distribution of income and the progressivity of the tax system.
- A province would have a greater ability to pursue horizontal equity goals under a separate PIT. For example, it would be possible to provide identical incentives to incorporated and unincorporated businesses. At present this is not possible.
- An alternative to the present 'tax on tax' system is the 'tax on base' or 'tax on income' approach. This would allow provinces to have their own rate and bracket structures but still ensure substantial tax harmony, since the underlying structure of the tax system would remain uniform. It seems to us that such an approach is consistent with the Tax Collection Agreements and yet goes some way toward allowing the provinces more freedom to tailor the PIT to their particular needs or desires without taking the final stage of adopting a separate PIT.

### Federal-Provincial Relations

- A greater degree of provincial autonomy with respect to the PIT would be consistent with the economic conception of federalism, which is to allow provinces the flexibility they need in order to deliver different bundles of public goods and services to their citizens. On the basis of international comparisons, Canada could probably tolerate more diversity in its PIT system. To be set against this potential benefit are a series of unknown efficiency costs as well as a set of administration/compliance costs that would attend a system of provincial PITs.

- Given its manufacturing and financial base, it is in Ontario's interest to have an internal market that is free of barriers to the movement of goods, services, and factors of production. Moreover, given that the Canadian market is already very small by international standards, a balkanization along provincial lines would be very costly. The Council takes a dim view of moves by any level of government that would further segment our internal market. It appears that the federal government relies on the Tax Collection Agreements as one of its principal instruments for ensuring a free internal market. This reliance reflects too narrow a conception of the underlying problem, since the internal market can be, and is being, balkanized on the expenditure and regulation front by both levels of government. In short, instead of a 'code of good tax conduct', the country needs a more general 'code of economic conduct' or 'code of fiscal conduct'. Moreover, it is important that the federal government also recognize that its own activities can and do serve to fragment interprovincial mobility.
- It is an unlikely case that there would be any lasting benefits associated with Ontario's implementing measures that were perceived by other provinces as being 'Ontario first' measures. Indeed, the opposite is more likely. Retaliation would likely convert these 'zero-sum games' into 'negative-sum games'. The very move by Ontario to adopt its own PIT could trigger separate PITs in other provinces, or vice-versa if Alberta or British Columbia follow through with their suggestions that they are contemplating going it alone on the PIT front.
- The Council believes that the preferable route would be for the federal government to accommodate some of the provinces' concerns within the framework of the existing Tax Collection Agreements. One option would be for the federal government to accept a more comprehensive system of provincial tax credits, provided that the credits did not discriminate against residents of other provinces. A better approach, in our opinion, would be to strike a federal-provincial committee on the shared PIT structure. The two parties to this arrange-

ment would have equal status, reflecting the fact that both levels of government have a constitutional right to engage in direct (i.e., PIT) taxation. The federal government, by the use of its own system of tax credits, could still implement policies that the provinces opposed, but they would not be binding on the provincial tax structure.

- It seems to us that the most likely way of precipitating a series of independent provincial PITs would be for the federal government to continue to demonstrate the insensitivity with respect to the provinces in tax matters that has characterized its attitude over the last few years.

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